

IT 97-14

Tax Type: INCOME TAX

Issue: Penalty Under 1002(d) - Failure To File/Pay Withholding

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	
)	
v.)	
TAXPAYER,)	
)	C. O'Donoghue
Taxpayer)	Admin. Law Judge
)	

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. TAXPAYER *pro se*; Mr. Thomas P. Jacobsen, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter comes on for hearing pursuant to the taxpayer's timely protest of Notice of Deficiency No. XXXX issued by the Department of Revenue ("Department") for withholding tax liability. The Notice of Deficiency ("NOD") was issued to TAXPAYER (hereinafter "TAXPAYER" or the "taxpayer") as a responsible officer of CORPORATION, Inc. pursuant to Section 1002(d) of the Illinois Income Tax Act.

The issues to be resolved are 1) whether the taxpayer was a responsible officer of CORPORATION Inc. and thereby required to collect, truthfully account for and pay over the withholding tax and 2) whether the taxpayer willfully failed to collect, truthfully account for and pay over the taxes for the fourth quarter of 1991 through the fourth quarter of 1992.

Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

1. The Department's *prima facie* case was established by the admission into evidence of the NOD, dated February 8, 1995, showing a proposed liability in the amount of \$13,807.34 for the tax period. Dept. Ex. No. 1.

2. TAXPAYER #2, TAXPAYER and TAXPAYER #3 formed CORPORATION Inc. ("CORPORATION") in either 1989 or 1990. Tr. pp. 35, 36.

3. CORPORATION sold wooden decks for consumers' homes. The company handled its own advertising, telemarketing, and newspaper advertising. Tr. p. 23. The deck installation was handled by independent contractors. Tr. p. 23.

4. TAXPAYER was the vice-president of the corporation. Tr. p. 36. He held approximately 40 to 45 percent of the company's shares of stock. Tr. pp. 36, 37. TAXPAYER #2 was CORPORATION's president and an equal shareholder. Tr. pp. 36, 37.

5. TAXPAYER was also a director of the corporation. Tr. p. 45; Dept. Ex. No. 9.

6. TAXPAYER signed the NUC-1, the Illinois business registration as vice president of the corporation. Dept. Ex. No. 6; Tr. p. 13. From the beginning of operations through the third quarter of 1991, the taxpayer admitted he was responsible for ensuring all bills were paid, including the company's taxes. Tr. p. 14. During this same time period, the taxpayer signed the payroll tax forms. Tr. p. 14; Taxpayer's Ex. Nos. 1-5. He reviewed the payroll, personally wrote all the payroll checks and signed them. He then presented these checks to TAXPAYER #2 who would review and also sign them. Tr. p. 58.

7. TAXPAYER was a signatory on the corporate account for the entire tax period. Tr. pp. 58, 59. Both TAXPAYER's and TAXPAYER #2's signatures were required on the corporate checks. Tr. pp. 58, 59.

8. Every month TAXPAYER compiled the installation data from the production managers, and the corresponding monies CORPORATION owed the production crews. He

presented this information to Ed TAXPAYER #2 and Jay Zeff, the controller. Tr. pp. 27, 33.

9. During the tax period, TAXPAYER was responsible for making sure that everything was running smoothly with the suppliers. On a daily basis, he coordinated the lumber deliveries for the scheduled jobs and kept in constant contact with the suppliers. Tr. p. 28. Taxpayer also handled any disgruntled suppliers. Tr. p. 29.

10. TAXPAYER's ensured all the installations were completed timely and collected the money owed to maintain the company's cash flow. Tr. p. 30.

11. At times the company would have disgruntled crews that were not paid and TAXPAYER would mediate between the crews and TAXPAYER #2. Tr. pp. 33, 34. TAXPAYER also handled difficult customers. Tr. p. 52.

12. Taxpayer reviewed a computer list of the backlog of deck installations which was generated every morning. The backlog could be anywhere from a half million dollars to a million dollars worth of installations. Tr. p. 51. TAXPAYER had daily meetings with TAXPAYER #2 regarding the backlog from the third quarter of 1991 up until October 26, 1992, the date on his resignation letter. Tr. p. 48.

13. Subsequent to the startup of operations, TAXPAYER invested \$15,000 in the company. Tr. p. 53.

14. TAXPAYER received a weekly paycheck from CORPORATION. Tr. p. 54. Due to a shortage of funds, the taxpayer agreed to forfeit his paycheck to strengthen the company's financial position. Tr. p. 55. He stopped receiving his ten thousand dollars per month salary in mid-1992. Tr. p. 64. He, thereafter, worked three or four months for free. Tr. p. 64. TAXPAYER knew that the reason he was not being paid was due to the company's poor cash flow and overall financial position and, furthermore, the money was needed to pay suppliers and other employees. Tr. pp. 64, 65.

15. During 1992, TAXPAYER was aware that CORPORATION was behind on paying some invoices, but assumed they were being paid. Tr. p. 61.

16. During 1992, TAXPAYER was aware that some employees were not paid by CORPORATION. Tr. p. 62.

17. TAXPAYER spoke with TAXPAYER #2 every day regarding the need to obtain the customers' guaranteed signatures and the balance due on a more timely basis. Tr. p. 63.

18. TAXPAYER #3 was a sales manager at CORPORATION in the Chicago office. Tr. p. 69. He was not a shareholder. Tr. p. 70. After a disagreement, TAXPAYER #2 removed TAXPAYER #3 from his position. Tr. p. 69.

19. TAXPAYER #3 left CORPORATION in the summer of 1991, prior to the tax period. Tr. p. 72.

20. Riecass was the assistant Chicago manager and training manager for CORPORATION. Tr. p. 73. He worked for CORPORATION from early 1990 through late 1991. Tr. p. 74.

21. Riecass left CORPORATION in late August of 1991, prior to the tax period. Tr. p. 78.

22. On November 25, 1992, taxpayer signed three documents: 1) Articles of Amendment, 2) A Statement of Unanimous Consent to Action in Lieu of a Special Meeting of the Common Class A Voting Shareholders of CORPORATION, Inc., and 3) Statement of Unanimous Consent to Action in Lieu of a Special Meeting by the Board of Directors of CORPORATION, Inc. Dept. Ex. Nos. 7-9.

23. On October 26, 1992, taxpayer resigned and ceased his involvement in CORPORATION's day to day operations. Taxpayer Ex. No. 6.

Conclusions of Law:

The Department seeks to impose personal liability on TAXPAYER pursuant to Section 1002(d) of the Illinois Income Tax Act which during the tax period provided:

Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the amount of the tax evaded, or not collected, or not accounted for and paid over

Ill. Rev. Stat. 1991, ch. 120, 10-1002(d).¹

Section 1002(d) is modeled after Section 6672 of the Internal Revenue Code, which imposes liability upon those individual persons actually responsible for an employer's failure to withhold and pay over the taxes. Allen v. United States, 547 F. Supp. 357 (N.D. Ill. 1982).

In determining whether an individual is a responsible person the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. See, e.g., Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), cert. denied 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the withholding taxes are remitted to the Government. *Id.* Thus, the statute does not confine liability to the single most responsible person. Howard v. United States, 711 F.2d 729 (5th Cir. 1983).

It is clear from both testimony and documentary evidence that TAXPAYER held the office of vice-president and director and was a majority shareholder in the corporation. Taxpayer allows that from the inception of business operations through the third quarter of 1991 he was actively involved in the payment of bills and reviewed, wrote and signed payroll checks and tax returns as a matter of course. Taxpayer contends, however, that all of his involvement in paying corporate bills and taxes ceased at the end of the third quarter of 1991. During the tax period at issue, taxpayer maintains he worked solely in the production area and was completely unaware of all the financial workings of the corporation.

¹. The Uniform Penalty and Interest Act, 35 **ILCS** 735/3-7, which provides for personal liability penalty, is effective for taxes incurred as of January 1, 1994.

Taxpayer, however, offers little in the way of credible testimony and documentary evidence to prove that his duties changed so drastically that during the tax period he was devoid of all responsibility. Taxpayer maintains that the controller and an independent accounting service handled the payroll, yet only offers his own testimony to prove such claims. Throughout the entire period, even after his alleged transfer to the position of production manager, he maintained the title of vice-president, he merely contends he no longer fulfilled the duties of this office during the tax period at issue. Further, it is noted that he continued to be a signatory on the corporate bank account throughout the tax period. Both TAXPAYER's and TAXPAYER #2's signatures were required on all corporate checks. TAXPAYER admits he met daily with TAXPAYER #2 and worked closely with the suppliers. It was his responsibility to maintain smooth relations with the suppliers and he testified that one of the reasons relations broke down was lack of payment. At times TAXPAYER knew employees and suppliers were not paid and yet contends he never discussed this with TAXPAYER #2, with whom he met daily. It is hard to imagine that TAXPAYER did not participate in decisions regarding the payment of these suppliers so as to keep the suppliers happy and the deliveries on time.

Taxpayer offers the testimony of two people, TAXPAYER #3 and Kurt Riecse to support his contentions, however, I find their testimony incredible and unpersuasive. Both individuals were solely involved in production and their responsibilities would not necessarily allow them the opportunity to observe all of TAXPAYER's duties as corporate vice-president. More importantly, both individuals left CORPORATION prior to the tax period at issue, and thus, had no direct knowledge of what TAXPAYER's duties entailed after their departure. It is interesting to note that both witnesses testified that TAXPAYER was not involved in the financial aspects of the corporation during the period of time TAXPAYER has heretofore admitted responsibility.

Further, Craig Krolici's affidavit can be given little weight. Krolici was the Chicago Production Manager until July 1992 and given his responsibilities, he would not necessarily be aware of the scope of TAXPAYER's duties. Taxpayer chose not to call him as a witness at the hearing which would have allowed for cross-examination, therefore, a proper determination of his credibility could not be made.

Taxpayer contends that TAXPAYER #2 had greater responsibility for the day to day operations of CORPORATION, as if this fact would somehow absolve him of liability for the taxes owed. It is well established, however, that there may be more than one responsible officer within a corporation, and the mere fact that other officers and employees also had control over financial matters does not exonerate TAXPAYER from liability. See, Gephart v. Unites States, 818 F.2d 469 (6th Cir. 1987).

Furthermore, the taxpayer has failed to submit credible testimony and sufficient documentary evidence to rebut the Department's *prima facie* case. The Department's determination relating to the tax penalty liability is *prima facie* proof of the correctness of the penalty due. Branson v. The Department of Revenue, 168 Ill. 2d. 247 (1995). The Department's determinations are rebutted only after a taxpayer introduces evidence which is consistent, probable and identified with taxpayer's books and records, showing that the Department's determination is incorrect. Copilevitz v. Department of Revenue, 41 Ill.2d 154 (1968); Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978). A taxpayer's oral testimony, without sufficient corroborative evidence, will not rebut the Department's *prima facie* case. A.R. Barnes v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988).

It must also be determined whether TAXPAYER willfully failed to remit the withholding taxes to the Department. Willfulness in regards to Section 1002(d) is not merely limited to "intentional, knowing and voluntary acts". Monday, 421

F.2d at 1215. Willful as applied in Section 6672, and hence 1002(d), encompasses a reckless disregard for obvious or known risks.¹ *Id.*

In Branson, *supra*, the Illinois Supreme Court held that the introduction of the Notice of Penalty Liability was sufficient to establish a *prima facie* case of willful failure to pay retailers' occupation taxes. To overcome the Department's *prima facie* case, taxpayer must offer countervailing evidence showing a lack of willfulness. The court was addressing the Retailers' Occupation Tax Act, however, the holding in Branson should apply equally in this case because not only are the underlying policies of the ROT section and section 1002(d) similar but the language of the two sections encompasses both responsibility and willfulness.

In the present case, however, there is evidence showing TAXPAYER acted willfully. In 1992, the taxpayer knew CORPORATION was having serious financial difficulties. He compiled the monthly deck installation data, so he knew what the approximate gross receipts were and how much the company owed the production crews. TAXPAYER was aware that the company was behind paying their suppliers, that some employees were not being paid and the company's financial position was so poor that he forfeited his own paycheck for three or four months.

Further, TAXPAYER's active involvement with suppliers and the daily meetings with TAXPAYER #2 reflect that he was an important and active participant in many facets of the corporation. TAXPAYER's position within the company enabled him to confirm payment of taxes since as a vice-president, director and shareholder of the corporation he had access to the company's books and records and had daily contact with TAXPAYER #2. The record reflects that TAXPAYER's signature along with TAXPAYER #2's was required on all corporate checks throughout the tax period. This would seem to indicate a level of involvement in the payment of

¹. The Illinois Supreme Court in Department of Revenue v. Heartland Investments, 106 Ill.2d 19, 29 (1985), accepted that cases arising under section 6672 of the IRC provided guidance in determining the meaning of the "willful failure" requirement of Chapter 120 par. 452 1/2 (13 1/2).

creditors which the taxpayer has not sufficiently disproved. Given all the financial difficulties, his awareness of the company's inability to pay suppliers and employees, and his responsibility within the corporation, TAXPAYER should have investigated whether the company's taxes were being properly remitted to the Department. The fact that TAXPAYER had adopted a "hear no evil - see no evil" policy does not relieve him of liability. Wright v. United States, 809 F. 2d 425 (7th Cir. 1987), accord, Calderone v. United States, 799 F. 2d 254, 260 (6th Cir. 1986), quoting Bolding v. United States, 565 F.2d 663, 674 (1977) ("Thus, it cannot be that 'a responsible officer may immunize himself from the consequences of his actions by wearing blinders which will shut out all knowledge of the liability for the nonpayment of [the corporation's] withholding taxes.'").

Furthermore, the taxpayer has also failed to submit credible testimony and sufficient documentary evidence of his lack of willfulness to rebut the Department's *prima facie* case. Given taxpayer's position of authority within the company, his mere assertion that he was unaware of the tax delinquencies is insufficient to rebut the *prima facie* correctness of the Department's proposed adjustments. Simply questioning the correctness of the Department's determination or denying its accuracy does not shift the burden back to the Department. Quincy Trading Post, Inc v. Department of Revenue, 12 Ill. App. 3d 725 (1973).

Lastly, taxpayer maintained that he resigned October 26, 1992 and produced a resignation letter. Accordingly, I find that the taxpayer is not liable for taxes accrued after his resignation date.

WHEREFORE, for the reasons stated above, it is my recommendation the Notice of Deficiency be finalized as revised by this recommendation.

Christine O'Donoghue
Administrative Law Judge